Abstract

The chapter discusses both the normative and the positive approach towards the economic analysis of constitutional law. With regard to the normative branch, Buchanan’s approach is shortly presented and evaluated. With regard to the positive branch, it is differentiated between research which is interested in explaining the choice of constitutional rules on the one hand and research which is interested in explaining the outcomes that (alternative) constitutional rules bring about on the other. Concerning the first research direction, a distinction between explicit and implicit constitutional change is proposed. Concerning the second direction, concepts such as the separation of powers, unicameral vs. bicameral systems and direct-democratic institutions are discussed. The entry closes with a proposal to complement the two existing branches with an ‘art of constitutional political economy’ which is conjectured to make the economic analysis of constitutional law more relevant in real world processes of constitutional choice.

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1. Introduction

The economic analysis of constitutional law has not been one of the most researched topics within law and economics. The special issue of the International Review of Law and Economics on ‘Constitutional Law and Economics’ (1992) is rather exceptional. The research program known as ‘constitutional economics’ or ‘constitutional political economy’ has primarily been developed by scholars emanating from public choice, that is, ‘the application of economics to political science’ (Mueller, 1989, p. 1). James M. Buchanan, the most prominent proponent of constitutional economics, has described law and economics as a related subdiscipline that remained, however, closer to orthodox economic theory because the standard efficiency norm remains central to it (Buchanan, 1987a, p. 586). Scholars of constitutional economics have broadened the standard research program of economics:
Standard economics is interested in the analysis of choices within rules, thus assuming rules to be exogenously given and fixed. Constitutional economics broadens this research program by analyzing the choice of rules using the standard method of economics, that is, rational choice.

Buchanan defines constitutions in their most basic sense as ‘a set of rules which constrain the activities of persons and agents in the pursuits of their own ends and objectives’ (Buchanan, 1977, p. 292). Defined as such, quite a few rule systems could be analyzed as constitutions: a firm’s partnership agreement as well as the statute of a church. Although such rule systems have indeed been analyzed from the point of view of constitutional economics (for a firm’s constitution, see Gifford, 1991, or Vanberg, 1992), the rule system analyzed most often remains the constitution of the state. Two broad avenues in the economic analysis of constitutions can be conceived of: (1) The normative branch of the research program is interested in legitimizing the state and the actions of its representatives. In other words: it is interested in identifying conditions under which the outcomes of collective choices can be judged as ‘fair’ or ‘efficient’. (2) The positive branch of the research program is interested in explaining (a) the emergence and modification of constitutional rules and (b) the outcomes that are the consequence of (alternative) constitutional rules (for a similar demarcation of the topic, see Mueller, 1996).

The chapter is organized as follows: Part A will be devoted to normative constitutional economics whereas Part B will deal with positive constitutional economics. The chapter closes with an outlook.

A. Normative Constitutional Economics

2. Methodological Foundations

Normative constitutional economics could deal with a variety of questions, for example: (1) How should societies proceed in order to bring about constitutional rules that fulfill some criterion like being ‘just’ or ‘efficient’? (2) What contents should the constitutional rules have? (3) Which issues should be dealt with in the constitution - and which should be left to sub-constitutional choice? (4) What characteristics should constitutional rules have? and many more. Buchanan answers none of these questions directly but hopes to offer a conceptual frame that would make them answerable. The frame is based on social contract theory as developed most prominently by Hobbes. According to Buchanan (1987b, 249), the purpose of this contractarian approach is justificatory in the sense that ‘it offers a basis for normative evaluation. Could the observed rules that constrain the activity of ordinary politics have emerged from agreement in constitutional contract? To the extent that this question can
be affirmatively answered, we have established a legitimating linkage between
the individual and the state.’

The value-judgment that nobody’s goals and values should a priori be more
important than those of anybody else, that is, normative individualism, is the
basis of Buchanan’s entire model. One implication of this norm is that societal
goals cannot exist. According to this view, every single individual has the right
to pursue her or his own ends within the frame of collectively agreed upon
rules. Therefore, a collective evaluation criterion that compared the societal ‘is’
with some ‘ought’ cannot exist since there is no such thing as a societal
‘ought’. But it is possible to derive a procedural norm from the value judgment
stated. Buchanan borrowed this idea from Wicksell (1896): agreements to
exchange private goods are judged as advantageous if the involved parties agree
voluntarily. The agreement is supposed to be ‘efficient’, ‘good’ or
‘advantageous’ because the involved parties expect to be better off with the
agreement than without it. Often, the exchange activities are considered to be
taking place only between two parties, the seller and the buyer. Buchanan
follows Wicksell who had demanded the same evaluation criterion for decisions
that affect more than two parties, at the extreme an entire society. Rules that
have consequences for every single member of a society can only be looked
upon as advantageous if every single member of that society has voluntarily
agreed to them. This is the Pareto criterion applied to collectivities. Deviations
from the unanimity principle could occur during a decision process on the
production of collective goods, but this would only be within the realm of the
Buchanan model as long as the constitution itself provided for a decision rule
below unanimity. Deviations from the unanimity rule would have to be based
on a provision that was brought about unanimously.

3. Giving Efficiency Another Meaning

Normative constitutional economics thus re-interprets the Pareto criterion in
a twofold way: it is not outcomes but rules or procedures that lead to outcomes
which are evaluated using the criterion. The evaluation is not carried out by an
omniscient scientist or politician but by the concerned individuals themselves:
‘In a sense, the political economist is concerned with “what people want”’
(Buchanan, 1959, p. 137). In order to find out what people want Buchanan
proposes to carry out a consensus test. The specification of this test will be
crucial as to which rules can be considered legitimate. In 1959, Buchanan had
factual unanimity in mind and those citizens that expect to be worse off due to
some rule changes would have to be factually compensated. This test would
thus be equivalent to a modified Kaldor-Hicks-criterion. In the meantime,
Buchanan seems to have changed his position: hypothetical consent deduced
by an economist will do in order to legitimize some rule (see, for example, Buchanan 1977, 1978, 1986). This position can be criticized because a large variety of rules seem to be legitimizable depending on the assumptions of the scientist who does the process. Scientists arguing in favor of an extensive welfare state will most likely assume risk-averse individuals while scientists who argue for cuts in the welfare budgets will assume people to be risk-neutral.

4. Critical Evaluation of Normative Constitutional Economics

The possibility of hypothetical consent crucially depends on the information assumptions. Buchanan and Tullock (1962, p. 78) introduced the veil of uncertainty in which the individual cannot make any long-term predictions on her or his future socioeconomic position. Rawls’ (1971) veil of ignorance is more radical because the consenting individuals are asked to decide on proposed rules as if they did not have any knowledge on their individual fate. Rawls’ veil is thus more demanding on the individuals. Both veils assume a rather curious asymmetry concerning certain kinds of knowledge: on the one hand, the citizens are supposed to know very little about their own socioeconomic position, but on the other, they are supposed to have at their disposal a consistent theory concerning the working properties of alternative constitutional rules (Reisman, 1990, pp. 23-30 describes the differences between the two conceptions of the veil).

In order to discuss the usefulness of the conceptual frame, suppose for a moment that it is impossible to legitimize a currently valid constitutional rule and that some constitutional economist has proposed an alternative rule for which she has ascertained a hypothetical consent. Further suppose that it is impossible to transform the hypothetical consent into majorities with which the constitution could be changed. Clearly, the non-legitimizable status quo would prevail over the legitimate constitutional rule.

B. Positive Constitutional Economics

Positive constitutional economics can be divided into two parts. On the one hand, it is interested in explaining the outcomes that result from (alternative) rule sets. Here, constitutional rules are part of the explanans. On the other hand, it is interested in explaining the emergence and modification of constitutional rules. In that case, they are the explanandum.
5. Constitutional Rules as Explanandum

5.1 Procedures for Generating Constitutional Rules
Constitutional rules can be analyzed as the outcome of certain procedures used to bring them about. Elster’s (1991, 1993) research program concerning constitutional economics puts a strong emphasis on hypotheses of this kind. He inquires about the consequences of time limits for constitutional conventions, about how constitutional conventions that simultaneously serve as legislature allocate their time between the two functions, about which effects the regular information of the public concerning the progress of the constitutional negotiations has and about how certain supermajorities and election rules can determine the outcome of conventions (Elster, 1991, p. 30). Some of Riker’s articles (1983, 1984) can also be interpreted as an encouragement to search for hypotheses of this kind. He calls for an extension of traditional rational-choice theory pointing to the fact that in its traditional form it is incapable of taking into account dynamic and creative processes which structure the decision room of the actors.

This part of constitutional economics does not offer a general perspective on the process of constitution-making (Elster, 1993, p. 174). There is, however, a large number of case studies (see, for example, the volume edited by Goldwin and Kaufman, 1988).

5.2 The Relevance of Preferences and Restrictions for Generating Constitutional Rules
Procedures are a modus of aggregating inputs and can therefore never bring about constitutional rules by themselves. It is therefore only a logical step to analyze whether a bunch of potentially relevant variables can explain the choice of certain constitutional rules. There are good reasons - and some empirical evidence - to assume that (1) the individual preferences of the members of constitutional conventions will directly enter into the deliberations, and that (2) the preferences of all the citizens concerned will be recognized in the final document in quite diverse ways. This would mean that rent-seeking does play a role even on the constitutional level, a conjecture that is often excluded by representatives of normative constitutional economics.

McGuire and Ohsfeldt (1986, 1989a, 1989b) have tried to explain the voting behavior of the Philadelphia delegates as well as those of the delegates to the 13 state ratifying conventions that led to the US Constitution. Their statistical results show that merchants, western landowners, financiers and large public-securities holders, ceteris paribus, supported the new constitution, whereas debtors and slave owners, ceteris paribus, opposed it (ibid., 1989a, p.175).
5.3 Explicit Constitutional Change

The two approaches towards constitutions as *explananda* just sketched are rather static. A third approach focuses on explaining the modifications of constitutions over time. Constitutional change that results in a modified document will be called explicit constitutional change here whereas constitutional change that does not result in a modified document - that is, change that is due to a different interpretation of formally unaltered rules - will be called implicit constitutional change.

One approach towards explaining long-run explicit constitutional change focuses on changes of the relative bargaining power of organized groups. Due to a comparative advantage in using violence (see North, 1981), an autocrat is able to establish government and secure a rent from that activity. As soon as an (organized) group is convinced that its own cooperation with the autocrat is crucial for the maintenance of the rent, it will seek negotiations with the autocrat. Since the current constitution is the basis for the autocrat’s ability to appropriate a rent, the opposition will strive after changing it. In this approach, bargaining power is defined as the capability to inflict costs on your opponent. The prediction of this approach is that a change in (relative) bargaining power will lead to modified constitutional rules (Voigt, 1997).

Explicit constitutional change can be sought by interest groups who try to convince legislators to change the constitution. If constitutional change is only sought in a disequilibrium, the interest group seeking change must perceive its own relevance as having changed. Boudreaux and Pritchard (1993) analyze the hitherto 27 amendments to the US Constitution from an economic perspective. They begin with the conjecture that a lobby-group interested in constitutional change principally has two possibilities of seeking its realization: it can either lobby for a simple law or it can lobby for constitutional change. The second option is, however, more expensive. The trivial prediction of rational choice theory is that the group will choose the option with the higher expected utility. In order to be able to make predictions about the option chosen, it is therefore necessary to specify the cost and benefit categories implied. Boudreaux and Pritchard specify two categories and predict a demand for constitutional change in cases in which the costs of maintaining an interest group over time are high, and today’s opposition is weak but expected to be strong in the future.

5.4 Implicit Constitutional Change

Implicit constitutional change has been defined as a changed constitutional interpretation that occurs although the formal constitutional document remains unchanged. This means that the conceptual separation between choice of rules on the one hand and choice within rules on the other has been factually blurred. This possibility must be disturbing to the proponents of normative constitutional economics. To adherents of positive constitutional economics, it
amounts to an analytical difficulty because the identification of what is analyzed as the valid ‘constitution’ either as \textit{explanandum} or as \textit{explanans} becomes more difficult. At the same time, the possibility of implicit constitutional change also becomes an object of inquiry. It can be asked which variables determine the scope and extent of the implicit constitutional change to be expected.

Suppose a constitution in the sense of constitutionalism exists and the government branches are legislature, executive and judiciary. If all government representatives have at their disposal a certain latitude concerning the interpretation of the constitution, it can be argued that all branches can bring about implicit constitutional change. If an independent judiciary exists, it seems plausible to assume that it has most latitude in causing implicit constitutional change because it has the power to judge the constitutional conformity of the actions of the other two government branches. It can now be argued that the judiciary is subject to a number of constraints among which those laid down in the original constitutional document play a rather marginal role. Instead, the current preferences of the other branches are more relevant restrictions. There are various factors that determine the latitude that justices have in bringing about implicit constitutional change. Cooter and Ginsburg (1996) show that it depends on the number of chambers whose consent is needed to pass fresh legislation. The higher its number, the more difficult it will be for the other branches to correct implicit constitutional change by changing the constitutional document explicitly. They further show (ibid.) that it depends on the existence of a ‘dominant disciplined party’. If such a party exists, it will be more difficult for the justices to bring about implicit constitutional change. Other variables that influence the amount of implicit constitutional change include the following: (1) If implicit constitutional change can only be prevented by changing the document explicitly, the necessary majority becomes a factor. The more inclusive it is, the more difficult it will be to prevent such change. (2) The possibility of referenda should be another explanatory variable. If the population at large can overturn the justices, they have an incentive not to deviate too drastically from the preferences of the median voter. (3) The extent of implicit constitutional change should be higher in common-law systems than in continental-law systems because in the first group decisions by justices become directly applicable law (see also Voigt, 1999).

6. Constitutional Rules as Explanans

In the previous section of this chapter, constitutional rules have been analyzed as \textit{explananda}. Such an analysis is only of interest if it can be shown that constitutional rules are themselves relevant to bringing about certain results or
patterns that concern economists or social scientists in general, in other words: if constitutions matter. Possible *explananda* include per capita income, its growth rate, but also income distribution.

6.1 The Separation of Powers

The analysis of economically relevant consequences of the separation of powers has long been neglected almost entirely. In a survey article, Posner (1987) writes that the separation of powers increases the transaction costs of governing. This would hold for welfare-enhancing as well as for redistributive or even exploitative measures. North and Weingast (1989) use the British case of the seventeenth century to demonstrate that the separation of powers can secure property rights because it is one way for the governing to credibly commit themselves.

Brennan and Hamlin (1994) develop a ‘revisionist view’ of the separation of powers. To make their point, they draw on standard monopoly models used in economics and distinguish between a horizontal and a vertical separation of powers. Starting out with a monopoly, the introduction of the horizontal separation amounts to two (or more) suppliers competing for demand and thus to the introduction of duopoly (or oligopoly). The equilibrium price will then be below the monopoly price and consumer rent will subsequently increase. A vertical separation of powers also entails a division of the original monopoly, albeit in a different way: now single functions of the process are divided; there is, for example, one monopolistic firm that produces certain goods and a second monopolistic firm that distributes it. Brennan and Hamlin call this functional separation of powers too. The (individually) maximizing strategies of the vertically separated firms will at best lead to the monopoly price, but usually the price will even be higher and the accruing consumer rent will thus be lower than in the original monopoly. Brennan and Hamlin argue that the separation of powers doctrine as conventionally understood is equivalent to the functional separation of powers and will therefore not protect citizens from exploitation by the governed. The horizontal separation of powers could, instead, have beneficial results. In order to unfold, it needs to entail an ‘exit’ option for citizens as well as the absence of strong externalities between competing states.

6.2 Unicameral vs. Bicameral Systems

A first attempt to compare the differential effects of unicameral and bicameral legislatures dates back to Buchanan and Tullock (1962, Ch. 16). In their analytical frame, that decision rule is optimal which leads to a minimum of interdependence costs which are defined as the sum of decision-making costs and those external costs an actor has to bear in case his individually most preferred outcome is not the outcome of the collective choice. They conjecture that in comparison with unicameral systems bicameral systems have higher
decision costs and continue: ‘on the other hand, if the basis of representation can be made significantly different in the two houses, the institutions of the bicameral legislature may prove to be an effective means of securing a substantial reduction in the expected external costs of collective action without incurring as much added decision-making costs as a more inclusive rule would involve in a single house’ (ibid., p. 235f.). The larger the majority required to reach a certain decision, the lower the external costs connected with that decision because the number of opponents to a decision is negatively correlated with the required majority. On the other hand, it will become increasingly difficult to reach a decision at all because the decision costs are positively correlated with the required majority. One possibility of keeping the external costs down is to require a supermajority (say of 3/4 or 5/6) in the single-house system. Supermajorities in a single-house system and simple majorities in a two-house system can thus be considered as alternatives. Buchanan and Tullock now conjecture that - given identical external costs - the decision costs would be lower in a bicameral than in a unicameral system.

Miller and Hammond (1989) inquire into the effects of bicameralism and the executive veto - which is sometimes simply considered the third chamber - on stability in the sense that it reduces the probability of cycling majorities à la Condorcet or Arrow (1951). They conclude that bicameralism and the executive veto increase stability. The stability-enhancing effect of bicameralism depends on some preference difference between the two chambers.

Levmore (1992) somewhat changes the focus of the analysis when he conjectures that a bicameral system might be better suited than a corresponding qualified majority in a unicameral system to reduce the power of the agenda settler. Bicameral systems are often interpreted as a break against overly active legislatures. Levmore relates this interpretation to the concept of federalism in a double sense: First, all federations have a bicameral legislature. Secondly, ‘(f)ederalism is likely to increase the chance of regulation because federal arrangements nearly always create some overlap in jurisdictional responsibilities so that there are multiple sources of regulation’ (ibid., p. 159). According to Levmore, federations tend to produce active legislatures but come systematically along with bicameral systems which tend to reduce legislator activism.

Concerning the effects of bicameral systems, one could analyze whether the legislative activity in bicameral systems is indeed lower than in unicameral ones, whether this is reflected in government consumption of economic output and whether there are even different growth rates. For a clear-cut comparative analysis of institutions the description of the exact functioning of the institutions to be compared is, however, primordial. One would have to inquire how a mediation committee influences the functioning of a bicameral system and how a presidential veto influences the decision and the external costs. More general inquiries into the (economic) effects of the separation of powers could
try to proceed by way of comparative institutional analysis, that is, by comparing common features of constitutions which do know a separation of powers with those which do not.

6.3 Direct-Democratic vs. Representative Institutions

Representatives of normative constitutional economics ask on what rules the members of a society could agree behind a veil of uncertainty. If they agree on a democratic constitution, they would further have to specify whether and to what extent they want to combine representative with direct-democratic elements. In order to make an informed decision, the citizens would be interested to know whether there are systematic relationships between these institutions and the patterns that they are interested in.

In a number of papers, Bruno Frey and his various co-authors argue that referenda are a feasible and effective institution for having the preferences of a society’s members reflected in the public goods bundle produced by the politicians. Referenda could make politicians’ cartels directed against the voters ineffective (Frey, 1994, p. 338). In 39 percent of the referenda that took place in Switzerland between 1848 and 1990, the majority among the population was different from the majority in Parliament (Frey and Bohnet, 1994, p. 73) which is interpreted as a proof of the hypothesis of a better reflection of voters preferences via referenda. Pommerehne already showed in 1978 that ceteris paribus tax rates are lower when taxpayers decide for themselves on the bundle of public goods supplied (for an overview over comparative studies, see Pommerehne, 1990). Additionally, taxpayer honesty is positively correlated with voters’ chances to participate directly in the choice of the bundle of public goods to be supplied (Pommerehne and Frey, 1992).

6.4 Individual Rights and Economic Growth

The question of whether societies whose constitutions grant individual rights to their citizens grow faster than societies that do not has often been answered using ‘democracy’ as a proxy for individual rights. The results of those studies have been mixed at best (for a survey, see Przeworski and Limongi, 1993). Bhalla (1994) proposes to search for a relationship not between democracy and growth rates but between political, civil and economic rights on the one hand and growth rates on the other. He finds a positive correlation not only between individual liberty and economic growth but also between political and civil rights and enrollment in secondary schools and a negative one between political and civil rights and infantile mortality. Bhalla shows that the availability of human capital is a necessary but not a sufficient condition for sustained economic growth. This will only occur if economic liberties come along with human capital. His study is thus also a challenge of the so-called new growth theory. Up to now, the most comprehensive study on the relationship between
individual economic liberties and growth is due to Gwartney, Lawson and Block (1996). For the period between 1975 and 1995, 103 countries are evaluated on an index comprising 17 components that puts special emphasis on the security of property rights and the freedom to contract. Two results are of special interest in this context: (1) There is a clearcut positive relation between individual economic liberty and per-capita income. There is reason to hypothesize that this not merely a correlation but also a causality: countries scoring best on the index of economic liberties first carried out liberalization and became wealthy only later on. (2) Economic liberties are also significantly correlated with a society’s rates of economic growth. Countries that liberalized most between 1975 and 1995 without exception secured positive growth rates.

To sum up: Economic liberties seem to enhance economic growth. Direct-democratic rights tend to make sure that citizen preferences are better reflected in policy outcomes. A federal structure might help to tame Leviathan and make the economic liberties more secure. Some normative conclusions thus almost seem to suggest themselves. Before drawing them, one needs, however, to clarify the conditions that have to be fulfilled in order to implement any of the above institutions successfully.

C. Outlook

John Neville Keynes proposed a tripartite division of political economy, introducing the ‘art of political economy’ besides the more standard positive and normative branches. This art deals with possibilities of reducing differences between ‘Is’ and ‘Ought’ (Keynes, 1955). It almost suggests itself to conceive of an ‘art of constitutional political economy’ analogously. This art would itself have to have a positive foundation: knowledge about the possibilities to modify constitutions intentionally is primordial for such a third branch. If one thinks that constitutional economics is potentially relevant for real world constitution writers, then one must be disappointed with the degree to which insights from this research program have entered into the newly written constitutions of Central and Eastern Europe. In order to become more relevant, it seems essential to work on the third branch.

A central presumption of both branches presented in Sections 2 and 3 is that constitutional rules constrain human behavior and that they can therefore be relevant for explaining it. Representatives of the new institutional economics would broaden this presumption and claim that institutions in general constrain human behavior. It thus almost suggests itself to plead for an integration of constitutional economics into the new institutional economics. Whereas Brennan and Hamlin (1995) argue that one can conceptualize the ‘new institutionalism’ as a subordinate research program, one can also argue exactly
the other way round: if one does not start with the assumption that constitutional design is possible to a large extent and if one is furthermore critical of the assumed hierarchy of rules, and rather points to the complex interdependence between informal constraints and formal rules (North, 1990) or between internal and external institutions (Kiwit and Voigt, 1995), one would tend to conceptualize constitutional economics as part of the new institutional economics.

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